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No. 322

In the Supreme Court of the United States

OCTOBER TERM, 1932

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statutes and regulations involved	2
Statement	3
Argument	4
Conclusion	8

CITATIONS

Cases:

Barto Co., The, v. *Commissioner*, 21 B. T. A. 1197 — 7
Brewster v. *Gage*, 280 U. S. 327 — 6
Fawcus Machine Co. v. *United States*, 282 U. S. 375 — 6
McCaughn v. *Hershey Chocolate Co.*, 283 U. S. 488 — 6
Seaboard Oil Co., Appeal of, 1 B. T. A. 1259 — 7
United States v. *Mitchell*, 271 U. S. 9 — 6
Utah Orpheum Co. v. *Commissioner*, 3 B. T. A. 1041 — 7

Statutes:

Revenue Act of 1924, c. 234, Sec. 245(a)(8), 43 Stat. 253, 289 (U. S. C., Title 26, Sec. 1004) — 5
Revenue Act of 1926, c. 27, 44 Stat. 9, 10, 41, 47—
Sec. 200(d) (U. S. C. App., Title 26, Sec. 931) — 4
Sec. 234(a)(2) (U. S. C. App., Title 26, Sec. 986) — 6
Sec. 245(a)(8) (U. S. C. App., Title 26, Sec. 1004) — 2
Revenue Act of 1928, c. 852, Sec. 203(8), 45 Stat. 791, 842 (U. S. C. Sup. V, Title 26, Sec. 2203) — 5

Miscellaneous:

Treasury Regulations 62, Art. 685(3) — 5
Treasury Regulations 65, Art. 685(3) — 5
Treasury Regulations 69, promulgated under the Revenue Act of 1926—
Art. 51 — 7
Art. 685 — 2
Treasury Regulations 74, Art. 975(3) — 5
Bulletin H, Income Tax Rulings Peculiar to Life Insurance Companies, published April 9, 1921 — 4

QUESTION PRESENTED

Whether the petitioner, a life insurance company making its return upon the basis of actual receipts and disbursements, is entitled to deduct from its gross income for 1926, as interest paid, the amount of interest credited by it to its policyholders during 1926 but not withdrawn by them.

STATUTES AND REGULATIONS INVOLVED

Section 245 of the Revenue Act of 1926, c. 27, 44 Stat. 9, 47, provides in part:

> SEC. 245 (a) In the case of a life insurance company the term "net income" means the gross income less—
>
> * * * * *
>
> (8) All interest paid or accrued within the taxable year on its indebtedness * * *;

Article 685 of Treasury Regulations 69, promulgated under the Revenue Act of 1926, provides in part:

> (3) The deduction allowed by section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by section 234 (a) (2) (see articles 561 and 121), but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.

STATEMENT

The findings of fact made by the Court of Claims (R. 11–15) may be summarized as follows:

Petitioner, a Massachusetts corporation, is a mutual life insurance company. (R. 11.) Its plan of operation contemplates the return to its policyholders, in the form of "dividends," of a portion of its earnings. Its policies provide that the dividends, when declared, may be withdrawn in cash, applied in various ways as premium payments, or allowed to remain on deposit with petitioner. (R. 15.) If the policyholder adopts the last course, the dividends accumulate at interest, which is added to the dividends at the end of each policy year. The dividends and accrued interest may be withdrawn by the policyholder on demand. (R. 15.) During 1926, the taxable year now in question, for which petitioner filed its income tax on the basis of actual receipts and disbursements, $544,964.40 became due the policyholders as interest on their dividends left with petitioner. (R. 11.) This amount was credited to the individual accounts of the policyholders during 1926 and was subject to withdrawal on demand. The amount of interest actually withdrawn during 1926, however, was only $248,405.97, all of which did not accrue in 1926. (R. 13.) In its income-tax return for 1926 petitioner sought to deduct as interest paid during that year the total amount, $544,964.40, credited to the policyholders' accounts, whether or not actually

paid out. (R. 11.) The Commissioner disallowed the deduction claimed by petitioner, and instead allowed a deduction only of the interest withdrawn by the policyholders. (R. 13.) Petitioner paid the additional tax resulting from the Commissioner's determination of its net income, duly filed its claim for refund (R. 13), and brought this suit to recover the additional tax. The Court of Claims dismissed its petition. (R. 19.)

ARGUMENT

The Commissioner's determination (approved by the court below) that only interest actually paid was deductible, is in accordance with Treasury Regulations that are controlling in this case.

Under Section 245 (a) (8) of the Revenue Act of 1926, *supra,* petitioner could deduct from its gross income "interest paid or accrued within the taxable year." The phrase "paid or accrued" is, under Section 200 (d) of the 1926 Act, to be construed according to the method of accounting employed by the taxpayer. In the case of life insurance companies, Treasury rulings in force since 1921 required returns to be made on the cash receipts basis, as being in accordance with the method of accounting employed by such companies.[1]

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[1] See *Bulletin H, Income Tax Rulings Peculiar to Life Insurance Companies*, published April 9, 1921:

"1. *Basis of returns.*—Returns of life insurance companies shall be made on a receipts and disbursements basis, as distinguished from an accrual basis, as being in accordance with the method of accounting regularly employed by such companies. * * *."

Treasury Regulations 62, Art. 685 (3), applicable to Section 245 (a) (8) referred to above, provided in effect that the interest payable by insurance companies on dividends that might be deducted was the amount paid out during the taxable year.[2] The statute was reenacted as Section 245 (a) (8) of the 1924 Act, 43 Stat. 253, 289, after this administrative interpretation, and the Regulations were carried forward into Regulations 65, Art. 685 (3). The provisions of the 1924 Act were reenacted without change in Section 245 (a) (8) of the 1926 Act, 44 Stat. 9, 47, and the Regulations were carried forward into Regulations 69, Art. 685 (3). The repetition was carried on in Section 203 (8) of the 1928 Act, 45 Stat. 791, 842, and in Regulations 74, Art. 975 (3).

Thus, the administrative interpretation of the term "paid or accrued" as applied to interest on dividends has, in the case of life insurance companies, been consistent and uniform. Petitioner argues that the Regulations are inconsistent with the Act, but the reenactment of the statute must be

[2] The Regulations provide that the deduction for interest on indebtedness "includes item 18 of the disbursement page of the annual statement of life companies * * *." Item 18 is the item that shows the amount of dividends and interest "surrendered during the year." In the instant case, the Commissioner allowed as a deduction the interest shown on item 18 of petitioner's annual statement as having been "surrendered," that is, actually paid during the taxable year. (R. 13.)

regarded as an adoption and ratification of the construction given it by the officers charged with its enforcement. See *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375, 378; *Brewster* v. *Gage*, 280 U. S. 327, 336. The clear intent of the statutes and Regulations was that insurance companies should deduct from their gross income only such sums as they actually disbursed.

Petitioner contends that this construction of the statute virtually eliminates the words "or accrued" from the interest provision of Section 245 (a) (8). Since all life insurance companies, so far as we are informed, keep their books upon a cash receipts basis and hence can deduct only interest paid out during the taxable year, the correctness of petitioner's contention may be conceded. It may be noted that Section 245 (a) (8) is in the exact wording of Section 234 (a) (2), 44 Stat. 9, 41, applicable to corporations in general, and that the statute was drafted without the modification that would fit it more accurately to the accounting methods of life insurance companies. The superfluous words, however, do not help the petitioner. In *United States* v. *Mitchell*, 271 U. S. 9, a taxpayer upon the cash receipts basis attempted to deduct an estate tax which accrued during the taxable year but was not paid until later. This Court held that under the 1918 Revenue Act allowing a deduction of "taxes paid or accrued within the taxable year" the estate

tax could not be deducted until in fact paid. See also *The Barto Co.* v. *Commissioner,* 21 B. T. A. 1197; *Utah Orpheum Co.* v. *Commissioner,* 3 B. T. A. 1041; *Appeal of Seaboard Oil Co.,* 1 B. T. A. 1259. In the instant case the petitioner was on the cash receipts basis, and the court below therefore correctly held that a deduction for interest could not be taken until it had been withdrawn by the policyholder.

Petitioner also contends that it "constructively paid" the interest during 1926, since, by Regulations 69, Art. 51, "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession * * *." Cases cited by petitioner support the Regulations, and show that taxpayers, even though they keep their books on the cash receipts basis, may "constructively receive" income in circumstances like the present. But "constructive payment" by a taxpayer is not covered by Regulations 69, Art. 51, or by any other Regulations of which we are aware. The cases cited by petitioner do not touch the question here involved. As the court below observed (R. 18):

> To hold that an amount credited by a taxpayer employing a cash receipts and disbursements method of accounting constitutes a payment, and is, therefore, deductible from gross income in the year in

which credited, would destroy the distinction between the accrual and the receipts and disbursements methods of accounting which is recognized and made controlling by the revenue statutes.

CONCLUSION

The decision below is correct. There is no conflict of authority. The petition should be denied.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
CHARLES B. RUGG,
Assistant Attorney General.
WHITNEY NORTH SEYMOUR,
Special Assistant to the Attorney General.
LISLE A. SMITH,
BRADLEY B. GILMAN,
WALTER GELLHORN,
Attorneys.

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